

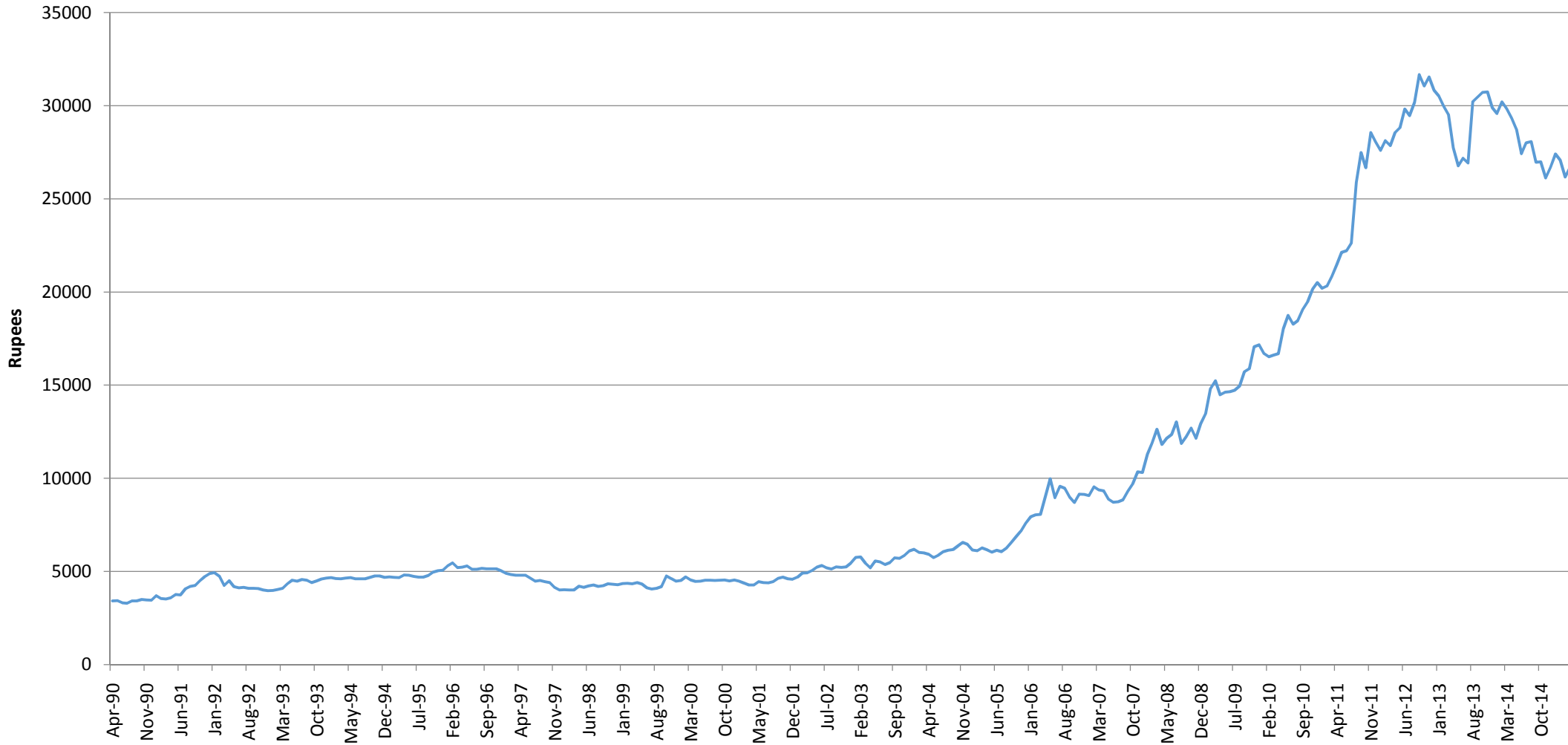
# Sovereign Gold Bond

Global Experience and Suggestions for India

# Gold -Indian Context

- Largest consumer of gold in the world
  - one-fourth of the world's total consumption
  - consumers in India have bought almost 4,500 tonnes of gold during past five years
- Integral part of social and cultural milieu
  - Indians have sentimental attachment
- Store of value and hedge against inflation
- Major contributor to the current account deficit
  - Several measures taken to stem the pressure on CAD from gold import such as increase in customs duty prohibition of import of gold coins and medallions; 80-20 scheme etc
  - Despite government restrictions, demand for gold remains strong and enduring... therefore need for fresh policy initiatives

# Gold Price



# Sovereign Gold Bond Scheme

- Honourable Finance Minister in his budget speech announced a Sovereign Gold Bond.
- Broad features of Draft Scheme
  - Issuance by RBI on behalf of the Government of India;
  - tenor of the bond at 5 to 7 years
  - nominal rate of interest say 2% (linked to international rate for gold borrowing);
  - sale to resident Indians only;
  - quantitative restriction of 500 grams per person per year;
  - collection and redemption through Banks/NBFCs/Post Offices
  - bond to be a part of the sovereign borrowing;
  - bonds to be used as collateral for loans;
  - easy tradability on exchanges;
  - KYC norms; capital gains etc. are similar to investments in physical gold.

# Global Experience

- Not many parallels to India as Indian attachment to gold unique
- Gold bond issued by South Africa
  - First Rand Bank has issued a gold bond backed by Krugerrands.
  - Earn 0.5% interest payable in gold
  - Tenor of five years
  - On maturity, investors can either claim gold or accept cash
  - Listed on Johannesburg Stock Exchange and enjoy good liquidity
  - Provide direct exposure to the rand gold price
  - offers both inflation and rand/dollar exchange rate protection
- Saw reasonable success

# Is there demand for an Indian sovereign gold bond?

- Indian consumers presumed to be attached to physical gold
- Outlook for financial products relating to gold was not considered positive
- Gold ETFs bucked trend
- Survey commissioned by the World Gold Council and conducted by the Federation of Indian Chambers of Commerce and Industry found that Indian consumers [more than 60 per cent of respondents] are prepared to use interest-bearing gold-savings products

# Product Design is the key

- Must provide correct incentives to the investors
  - to postpone their investments in physical gold
- Interest rates need to be reasonable and in alignment with monetary policy objectives
- Ensure effective distribution for product to succeed
  - Banks / NBFCs / Post Offices
- Secondary market Liquidity needs to be ensured
  - Through exchanges
- Bond must be widely accepted as collateral
- Banks need to be oriented to create loans products around the bond. Success story of AP.

# Some Points to ponder...

- Gold price has remained highly volatile during recent years

During April 2010 to March 2015

- Coefficient of variation was 16 per cent
- Gone up by about 57 per cent
- Compound annual growth rate of around 9.5 per cent
- Between end-March and end-July 2015, gold price in rupee terms has fallen around 6 per cent.

- But gold prices by and large showing increasing trend over last twenty years

- Price risk on the amount of bonds issued due to international gold price movements

- To keep the risks at low level, proposed issuance is capped at Rs. 12,500 crore [around 50 tonnes in the first year]

- 50 tons forms just 3.75 % of last fiscal year's imports of 1,332 tonnes – barely makes a dent in demand

## Some Points to ponder...Cont..

- International gold price might fall due to strengthening of US Dollar in response to expected increase in interest rates by the US Fed
  - investor response might be tepid for fear of capital loss
  - Demand for physical gold may continue since loss is not realised in monetary terms
- Success depends on the distribution channels
- Timing of issuance of Sovereign Gold Bond scheme is crucial as global factors impact gold demand
- Reserve Bank targeting CPI and moving to a monetary policy framework that clearly articulates medium term inflation target, inflation is expected to remain benign. Demand for gold as inflation hedge may be impacted.

# Way Forward...

- Draft scheme appears to be a step in the right direction
- The target of fifty tons may not be very large but the response to the scheme would determine future contours
- Certain design issues that need to be ironed out viz. setting of interest rate, ensuring wide distribution etc.
- The government to be cognizant of the potential risks to the fiscal position upfront and monitor them on regular basis
- Positive feedback to draft scheme and Government's policy intent encouraging factors